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The Buck Stops With You

*California Joan explains how to stay out of trouble
by keeping a close watch on your client trust account*

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Addressing a sea of lawyers at the State Bar's Annual Meeting, California Joan started: "I'd like to tell you a true tale about a good, honest lawyer who was suspended because of trust account thefts she did not commit.

One early Monday morning in 1998, Monica Malek-Yonan opened the door to her Orange County office, finding it empty and almost all client files missing. With the help of police, she retrieved most of her client files from Ken (her assistant), Ali (her bookmaker) and Veronica (Ken's wife and office manager)." (*Matter of Malek-Yonan* (2003 Rev. Dept.) 4 Cal. State Bar Ct. Rptr. 627, 631-632 ("*Malek-Yonan*")

In Ali's briefcase, there was \$4,000 in cash, a number of settlement checks, checks payable to doctors, her rubber signature stamp, and some documents to make wire transfers to Swiss bank accounts. After the dust settled, Monica determined that Ali, Ken and Veronica had embezzled about \$1.7 million from her client trust account. Using her signature stamp, they issued more than 200 bogus checks payable to bogus clients, who would cash the checks and return the money to Ali, Ken and Veronica. Monica was never able to determine how much of the embezzled monies derived from her fees, client funds or medical care providers liens. (*Id.*, p. 632)

Although Monica tried to repay all clients who had lost funds, she was ultimately forced to go through bankruptcy proceedings. In the subsequent disciplinary case, Monica narrowly escaped the disbarment recommended by the trial judge when the State Bar Court review department recommended that Monica be suspended for a period of five years, execution stayed, on condition of five years probation, including actual suspension for eighteen months." (*Id.*, p. 640)

Monica did not misappropriate one dime of her clients' funds. She was not charged with nor disciplined for failing to prevent her employees' theft of funds. Instead, she was disciplined for failing to have adequate office procedures in place to protect client funds and to adequately supervise her subordinate staff to ensure that those procedures were followed, which the review department concluded constituted gross negligence involving moral turpitude. (Rule 3-110(A), California Rules of Professional Conduct (CRPC) and Bus. & Prof. Code §6106; *Id.*, pp. 634-635)

Monica's story is not unusual. Many of the most serious client trust account losses have resulted from non-lawyer malfeasance or misfeasance." (See *Aronin v. State Bar* (1990) 52 Cal.3d 276, 284, 276 CalRptr. 160, 163 — attorney's spouse, a compulsive gambler 'invaded' his clients' trust account and his former secretary misappropriated funds from his clients' trust account; *Matter of Jones* (Rev. Dept. 1993) 2 Cal.State Bar Ct. Rptr. 420-421 — office manager misappropriated medical lien monies received in personal injury settlements; *Matter of Steele* (Rev. Dept.) 3 Cal.State BarCt. Rptr. 708 — lawyer permitted office manager to run his practice, sign client trust account checks and handle all financial transactions without supervision, despite evidence that the employee was embezzling funds; *Matter of Sampson* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 119, 126-127 — chaos and failure to supervise personal injury practice resulted in clients' trust account short fall.)

Sam Solo, a lawyer in the audience, stood up and asked: "I need to spend most of my time practicing law for the benefit of my clients. I need to use non-lawyer clerical and financial assistants to help in the management of clients' trust accounts (CTA). What office procedures and practices can I put into place to prevent the likelihood that non-lawyer assistants can steal my client monies?"

There are a number of simple do's and don'ts that can prevent CTA theft by non-lawyers," Cali responded. "First, like Monica, don't have any non-lawyer signato-

ries on your CTA. Unlike some states, California has no prohibitions upon allowing non-lawyer signatories on client trust accounts. While most non-lawyer assistants are trustworthy, why tempt any non-lawyer by giving them access to the CTA? I have seen many unreported cases in which longtime trusted employees or independent financial professionals suddenly embezzled funds because of changing financial needs, spite towards their employers or other personal situations.

Also, don't make Monica's mistake: don't give a non-lawyer assistant a rubber signature stamp enabling them to write checks at will."

Terry Trust, another audience member, added: "Don't permit them to use your computer-generated signatures or give them the power to transfer money from the CTA to another account to which they are signatories."

Don't have an ATM card that permits withdrawals. If you do online banking with your CTA, make sure that you have procedures to protect unauthorized access. If you have telephonic transfer capacity, make sure that your bank has protective protocols in place. And, of course, never give your assistants the passwords and protect them from discovery," suggested another participant.

As a solo practitioner, how will my clients or third parties get CTA funds if I am unavailable or, worse, incapacitated?" Sam Solo asked. "Law firms can simply have two or more lawyer signatories, but what can I do if I should not use a non-lawyer assistant?"

Terry Trust interjected, "If I'm on vacation or a long business trip and an emergency need for trust account disbursements occurs, I have always been able to deal with the emergency by using overnight delivery services or working with my bank manager to achieve a telephonic transfer or some other solution."

But if those are not possible, or in the event of lawyer incapacity, Sam's pointing to the importance of having more than one CTA signatory," Cali responded. "Here are some methods used by other lawyers:

- If a sole practitioner employs or associates an attorney in whom the sole proprietor reposes trust and confidence, that attorney may be an appropriate signatory to the clients' trust account when the sole proprietor cannot act. The sole proprietor should go one step further: have a written memorandum, signed by the other attorney signatory, which clearly states the scope of authority of the other attorney to sign disbursement checks or make other withdrawals from the clients' trust account.
- Another alternative is to create a power of attorney authorizing another trusted attorney to sign checks and drafts in the sole proprietor's name for deposit into the CTA, to sign disbursement checks or make other withdrawals from the CTA. The power of attorney should set forth when and under what circumstances it may be exercised and the necessary documents should be given to the bank.
- Yet another alternative is to create a law firm trust agreement which provides that another lawyer trustee will have specific powers over a CTA to protect the clients' interests in the event that the sole practitioner is unavailable for a substantial period of time, disabled or dies, until the sole practitioner returns or until the practice is sold or wound down."

Why do you assume that non-lawyers are less trustworthy than lawyers? Every month there are lots of reports of lawyer CTA violations and discipline," said Irving Incredulous.

While lawyers have also stolen or mismanaged trust funds, lawyers are statistically less likely to commit theft because it will jeopardize their license. Even where lawyer vs. non-lawyer theft occurs, however, there is more client protection. If a lawyer is dishonest with client funds, the client can obtain court-ordered restitution from the disciplinary process and may make a claim for reimbursement for losses of up to \$50,000 from the State Bar Client Security Fund," answered Cali.

Cali continued with other loss prevention techniques:

- Do a background check of any non-lawyer assistants who deal with CTA matters. Had Monica done so, she would have found that Ken had served two terms in prison, one for drug trafficking." (*Malek-Yonan*, supra, p. 631)
- Keep your CTA checks and records in a safe place, preferably locked, to prevent theft or alteration."
- Do not pre-sign blank checks. One of the things Monica did right was insist that the disbursement sheet and any CTA disbursement checks be presented to her prior to distribution, accompanied by the file or other documentation by which she could determine that the payee, amount and purpose are appropriate. (*Id.*, 631) After following this procedure, then sign the checks and have them disbursed."

Irving Incredulous interjected: “But Monica’s employees then did not always disburse the checks. (Id., p. 631) Surely, you are not suggesting that we watch and make sure every check is handed to the client or inserted into an envelope and mailed?”

No, Irving, I’m afraid that thieves will always invent new and clever ways to steal money,” Cali answered. “Sadly, we cannot prevent all theft all of the time. We can, however, employ procedures that don’t hand the henhouse to the foxes on a silver platter, such as allowing the use of electronic and mechanical signature devices. We can employ procedures to make it tougher to steal from us.

We cannot stop with prevention procedures. We must also employ procedures to monitor CTA activity in order to detect and remedy any CTA irregularity.”

Terry Trust chimed in: “I always insist that my bank records be delivered to my desk unopened. I look through the cancelled CTA checks just to make sure that no checks are written to bogus parties or that my signature is not being forged on checks or that there are no checks payable to ‘cash.’ A friend has his monthly CTA bank statements delivered to his home address rather than his business office.”

Cali pointed out that if Monica had employed this procedure, she would have discovered the checks going to bogus clients much sooner. (Id., pp. 631-632)

Standard 1(d) to CRPC 4-100(C) requires that lawyers maintain a monthly ‘reconciliation’ which reconciles the written ledger for each client, the written journal for each CTA, bank statements and canceled checks.” Cali continued, even though she heard several members of the audience sigh, groan and hiss at the “reconciliation’ requirement, “Many of you think that reconciliations are an unnecessary burden . . .”

Terry Trust jumped up and addressed the crowd, “My reconciliation saved my ticket! One month, I found out that my bookkeeper had made a \$6,000 CTA mathematical error in distributing my fees from a personal injury settlement. I was able to deposit the \$6,000 as restitution to ensure that no client suffered any loss. (*Guzzetta v. State Bar* (1987) 43 Cal.3d 962, 978-979) Like Monica, the State Bar probably would not have disciplined me for misappropriation because of the mathematical error of my bookkeeper. If I had not discovered the error through regular supervision, I could have been disciplined for failure to supervise and gross negligence!” (*Malek-Yonan*, supra, pp. 632-633; *Matter of Respondent F* (Rev. Dept. 1992) 2 Cal.State Bar Ct. Rptr. 17, 26)

Moreover,” added Cali, “rigorous adherence to a monthly reconciliation will permit you to discover any irregularities, whether caused by associated attorneys, employees or independent contractors, in CTA activities. If Monica had supervised a regular monthly reconciliation, she would have discovered the bogus checks much earlier.”

Irving asked, “Suppose I did everything everyone has suggested, and one month I discover that a rogue employee absconds with more money than I can pay back. What can I do?”

The third risk management step in CTA management is to take steps to prevent client loss of funds, including having the funds to make restitution,” Cali responded.

First, get fidelity bond coverage or other insurance for malfeasance or misfeasance of your attorney and non-attorney employees or other independent contractors. If an employee, bookkeeper or accountant embezzles client money, the client’s money may be adequately protected by the fidelity bond, thus possibly preventing disciplinary or civil problems to you for failure to make good the loss to the client.

Second, get overdraft protection for your client trust account. Over-draft protection ensures that clients will not be harmed by a drop in the client trust account. ”

The State Bar advises against having overdraft protection,” Irving objected. (*Handbook on Client Trust Accounting for California Attorneys* (Calif. State Bar Jan. 2003) at p. 10)) “The reason is that you should never have insufficient funds in your CTA.”

Cali responded, “Of course, no CTA should ever have insufficient funds. However, as the State Bar’s own annual reports demonstrate, 3,000-4,000 instances of insufficiently funded CTAs occur annually. My experience is that the insufficient fund status is caused less by trust account mismanagement than from simple clerical and mathematical errors, bank error or even client retainer checks bouncing. Regardless of the cause of CTA insufficient funds, the client and third parties should not suffer any delay in payment or be charged a hefty administrative fee for processing the “NSF” or dishonored check. I disagree with the State Bar’s position because it is contrary to consumer protection.”

Irving introduced the second reason against overdraft protection: “CRPC 4-100(A) states that you cannot deposit your own funds in a CTA. Overdraft protection is a personal loan from the bank to you to cover the difference, and thus constitutes a deposit of your own funds.”

Cali continued, “In the Guzzetta case (supra), the California Supreme Court held that the deposit of a lawyer’s personal money to make restitution is not commingling and not a violation of CRPC 4-100(A). As a matter of public policy, the Supreme Court has expressed that restitution to clients or third parties is not a violation of the CTA rules.

Overdraft protection does not protect the lawyer from the State Bar discovery of the insufficiently funded CTA; your bank will still notify the bar of that fact. Instead, it is a consumer protection measure to ensure that clients and third parties will not suffer delay or other harm, whatever the cause of the insufficient funds. There is some mitigating benefit to lawyers since restitution is instantaneous. The choice is yours.

We have discussed a number of risk management ideas for implementing adequate office procedures to protect client funds and to adequately supervise subordinate staff to ensure that those procedures are followed. You should continue to think of improvements and additions.

Remember,” Cali concluded, “when it comes to assuming responsibility for the safety of clients’ funds, the buck stops here.” (*Matter of Robins* (Rev. Dept. 1991) 1 Cal. State Bar Ct. Rptr. 708).

■ *Ellen Peck, a sole practitioner in Escondido, California, is a former judge of the State Bar Court, a past chair of the State Bar’s Committee on Professional Responsibility and Conduct, a member of the Commission to Revise the Rules of Professional Conduct, a visiting professor of Professional Responsibility at Concord University School of Law and is a co-author of The Rutter Group’s California Practice Guide — Professional Responsibility.*

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Test — Legal Ethics

1 Hour MCLE Credit

1. A lawyer whose employees stole \$1.7 million from her client trust account without her knowledge or participation will be prosecuted and disciplined for failing to prevent her employees' theft of funds.
2. No attorney has ever been disciplined for failing to maintain procedures to protect a client trust account from invasion by a spouse with a gambling addiction.
3. There is no California professional standard which prohibits a non-lawyer from setting up and administering a client trust account.
4. A lawyer may be disciplined for gross negligence in failing to supervise non-lawyers' work which results in a client trust account shortfall.
5. California's professional standards prohibit non-lawyer signatories to client trust accounts.
6. California's professional standards do not prohibit the use of electronic, mechanical or rubber signature stamps in place of a lawyer's actual signature on a CTA disbursement check.
7. An ATM card permitting withdrawals from your CTA creates a risk of loss of entrusted funds.
8. Management of client trust accounts using electronic on-line computer banking is permissible provided that a lawyer implements procedures to protect unauthorized access by third parties.
9. A sole practitioner should consider having back-up CTA signatories in the event that entrusted funds need to be disbursed and the lawyer is unavailable or becomes incapacitated.
10. Sole practitioners may permit a trusted associate attorney to be a back-up signatory on a CTA.
11. Creating a power of attorney or designating a lawyer trustee in a law firm trust agreement to have designated powers as a CTA signatory are other available means of providing for a CTA signatory when a sole practitioner is unavailable or incapacitated for a prolonged period of time.
12. A lawyer who commits misconduct resulting in loss of client funds may, as part of a disciplinary proceeding, be ordered to pay restitution.
13. Clients may make a claim for reimbursement for losses of entrusted funds up to \$50,000 from the State Bar Client Security Fund as a result of lawyer dishonesty.
14. Doing background checks on employees who assist in trust account management or administration is of no value.
15. California lawyers are required to reconcile their client trust account quarterly.
16. An appropriate reconciliation reconciles each CTA written journal with monthly bank statements.
17. Rigorous adherence to CTA reconciliation is a powerful risk management tool.
18. Fidelity bond coverage or other insurance to cover malfeasance or misfeasance of attorney and non-attorney employees or other independent contractors is an important risk management tool to enable a lawyer to make restitution for entrusted funds wrongfully taken from a CTA.
19. California professional standards prohibit having overdraft protection for a client trust account.
20. If a lawyer discovers that money from his or her client trust account has been wrongfully disbursed, the lawyer may deposit his or her own funds in a client trust account to replace the missing client funds.

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1 HOUR CREDIT LEGAL ETHICS

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